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21 July 1966

Introduction: This briefing discusses two major problems in Indonesia. The first part is devoted to the political scene, which we feel is developing quite satisfactorily. The second part deals with the economic situation, which is critical and may block the progress being made in the political arena.

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Political

The Indonesian domestic political situation continues along lines favorable to the army and to its chief, Lt. Gen. Suharto. In contrast President Sukarno's position and prestige are progressively declining.

Suharto's power was significantly strengthened by action of the Indonesian Congress which ended 6 July.

In a series of wide-ranging decrees the congress:

(1) reaffirmed Suharto's special executive powers granted by Sukarno last March, (2) revoked Sukarno's life presidency but provided that he remain in office until an elected congress chooses a president--some two years hence, (3) gave Suharto a mandate to form a new cabinet by mid-August, (4) reaffirmed Suharto's earlier ban on the Indonesian Communist Party and in addition proscribed the propagation of Marxism-Leninism

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"in any form," (5) decreed that elections be held within two years and that an election law be written within six months.

Suharto is now forming a new cabinet which we expect to be announced in the next three weeks. The new cabinet will be smaller than the present one and probably will be headed by Suharto.

He wants to retain two close associates, Adam Malik, currently foreign minister and in charge of all social-political affairs, and the Sultan of Jogjakarta who has presided over economic and financial affairs. Suharto would prefer a cabinet of technicians but some accommodation to Sukarno and the political parties is inevitable. The nation's two largest parties--the Moslem Nahdatul Ulama (NAH-DAH-TOOL OO-LAH-MAH) (NU) and the National Party (PNI) are likely to get posts with prestige if not with influence.

Suharto has two major domestic political tasks: (1) the control of Indonesia's opportunistic political factions, (2) the continued downgrading of Sukarno and Sukarnoism--a delicate task in view of Sukarno's significance in emotional terms to the average Indonesian, particularly in densely populated Java. Minor incidents provoked by pro-Sukarno elements are still occurring in East and Central Java.

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Indonesia is firmly embarked on a course of friendly relations with the West. Foreign Minister Malik has stated that Indonesia hopes to be back in the United Nations as an active member by late September. Indonesia has sharply disengaged from Sukarno's pro-Peking policy and has considerably curtailed its diplomatic efforts in the Afro-Asian world.

Indonesia has publicly announced its desire to end the three-year confrontation with Malaysia and has initiated talks to this end with Malaysian officials. Indonesia appears to want the economic and diplomatic benefits which would accrue from friendly relations with Malaysia but at the same time still wants to subvert Malaysia's Borneo territories of Sabah and Sarawak. Infiltration operations to this end are still going on.

Economic

The Indonesian economy is in chaos. The country's most urgent problem is how to get the bankrupt economy back on a sound basis. The nation's economic plight may become the country's ultimate political problem. So far Sukarno and those who advised him in the pre-October period are still being blamed for the galloping inflation, declining production, and tremendous foreign debt.

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Unless this decline can be arrested, however, an antiregime atmosphere could easily develop which could be exploited by the political parties, coup-minded army officers, extreme nationalists, and Communist elements. Political chaos or a complete army take-over could be provoked and a return to authoritarian government could occur.

Suharto and those around him are aware of these possibilities. They base their hopes for economic progress largely on an input of foreign aid as a boost toward long-range stabilization.

The Indonesian Government faces both short- and long-term foreign obligations--more than \$2 1/2 billion--far beyond its ability to pay. The USSR is Indonesia's largest creditor--mainly for military assistance. There are no foreign exchange reserves and \$160 million in foreign obligations are in default. 1966 debt servicing requirements are estimated at \$550 million--more than Indonesia's current annual export income.

Indonesia wants to reschedule payments on its international debt and wants help in working out a domestic program of economic stabilization.

Creditor nations agree that debt rescheduling should be approached on a multilateral basis. Representatives

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of nine creditor nations who met formally in Tokyo on 19 July recognized the urgency of Indonesia's economic problem and agreed to a formal multilateral conference in mid-September. The nine nations were the United States, Japan, United Kingdom, Netherlands, West Germany, Italy, France, Australia, and New Zealand with Canada as an observer. The July meeting in Tokyo is expected to produce little more than the framework for more extensive negotiations in the fall.

Indonesian industries are operating at less than 30 percent of capacity. Industry is seldom able to secure the spare parts and raw materials needed to get the economy moving. Even agricultural production--normally 60 percent of the national income--has declined and is now lower than in the period prior to World War II. Only petroleum, which remains under foreign management, has prospered.

A basic problem of the Indonesian economy is the lack of managers, skilled labor, and entrepreneurial talent. The Dutch provided little training for the Indonesians, and the Indonesians have aggravated the shortage by ousting foreigners with managerial and technical skills. Repressive actions against the Chinese since the Oct. 1 coup have further reduced the ranks of traders and entrepreneurs.

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The nation needs widespread restoration of roads and railroads to carry rice into the cities, move export commodities to seaports and supply villages with consumer goods. Almost 55 percent of all Indonesia's motor vehicles are broken down because of the lack of spare parts. Many roads have reverted to jungles, and less than five percent of the railroad track is considered safe.

Grandiose--and unproductive--public works projects of the Sukarno era and expenditures associated with the Indonesian military have been the most important items in the government budget. Progress on the Sukarno pet projects has been stopped. However, with the military leaders in control of the government, there is little prospect that expenditures for the maintenance of armed forces personnel can be reduced. Expenditures for sophisticated military hardware may be curtailed. In addition, it may be possible to use military personnel in civic action programs to aid economic recovery.

No quick, easy solution is available for the Indonesian economy. Some progress has been made. Trade with Singapore is to be resumed. Trade regulations have been altered to encourage exports. The government has reapplied for membership in the International Monetary Fund. The Fund will send an expert team to help mold

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a financial program to restore international credit and domestic financial responsibility on readmission.

However, recovery will require years of effort even if the best domestic talent and liberal foreign economic assistance are made available. Indonesia has the climate, land and people to build a comfortable if not a flourishing economy. Organization and motivation of the population will be difficult.

Indonesia has fled from crisis to crisis for years. The country can do so again. Foreign aid can give the country hope and tools. It cannot give them will and dedication. The most encouraging sign is that the present leadership seems inclined to face reality. They recognize the sources of the present economic chaos if not its full magnitude.

Conclusion:

It is our view that if short-run foreign assistance is forthcoming, the country can get the breathing spell needed to organize an effort toward restoration and modernization. At the same time, the US will have valuable time to make a hard-nosed appraisal of the capability of the Indonesian leaders to develop a viable state.

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